

SURREBUTTAL TESTIMONY OF
GLENN L. DAVIDSON *CILCO*
ON BEHALF OF
CENTRAL ILLINOIS LIGHT COMPANY
DOCKET NO. 00-0579 *12/18/05*

00-0579

7.0

and

1 Q1: Please state your name and business address.

2 A1: My Name is Glenn L. Davidson, and my business address is 300 Liberty Street, Peoria,
3 Illinois, 61602.

4 Q2: Are you the same Glenn L. Davidson who previously submitted prepared direct testimony
5 and prepared rebuttal testimony in this proceeding?

6 A2: Yes, I am.

7 Q3: What is the purpose of your prepared surrebuttal testimony?

8 A3: I will respond to those portions of the rebuttal testimony of Staff witness Larson and IIEC
9 witness Dauphinais that are related to my prepared rebuttal testimony.

10 Q4: What issues are raised by Mr. Larson to which you are responding?

11 A4: In his rebuttal testimony, Mr. Larson argues that I incorrectly calculated the cost of coal from
12 the Freeman Crown II mine, by adding on an additional profit factor that is already included
13 in the beginning price I used. Mr. Larson contends that after subtracting the \$6.4 million
14 underpayment from 1999 that is being collected in 2000, the net price from Freeman should
15 be \$31.90 per ton, including the profit adder and taxes. He believes that I erred by adding a
16 duplicate profit factor and taxes.

17 Q5: What is your response?

18 A5: Mr. Larson's calculations are incorrect, and the proposals he continues to make in his rebuttal
19 testimony are arbitrary and unsupportable.

20 Q6: Please explain why Mr. Larson's calculations are incorrect.

21 A6: CILCO has furnished to Mr. Larson the actual production figures and production cost data
22 provided by Freeman for the Crown II mine through the third quarter of 2000, but Mr.
23 Larson instead relies upon the information shown on Form 423 filed with FERC, because
24 that information appears to show lower costs. CILCO has reviewed and compared the actual
25 Crown II costs with the amounts shown on Form 423, and has determined that Form 423
26 contains errors. Accordingly, Mr. Larson's calculations based upon Form 423 are not
27 accurate. Further, at lines 64 through 74 of his rebuttal testimony, Mr. Larson calculates a
28 cost of \$31.90 per ton for Crown II coal. Based upon Form 423, he concludes that a total of
29 756,100 tons of coal had been delivered to CILCO at a price of \$30,518,683. As set forth in
30 my rebuttal testimony, the actual tonnage was 711,875 tons at a production cost of
31 \$31,979,016, for a cost of \$44.922 per ton. That data was taken directly from Exhibit A of
32 the third quarter 2000 statement from Freeman, which is contained in CILCO's Surrebuttal
33 Exhibit 7.1 (Confidential), a copy of which was previously furnished to Mr. Larson. The
34 exhibit shows clearly that the production costs do not include the profit factor or taxes. Even
35 accepting Mr. Larson's figures for purposes of discussion, he deducts \$6.4 million from the
36 production costs he used to represent the recovery in 2000 of undercharges from 1999.
37 However, all the data CILCO has provided to Mr. Larson shows that the 1999 undercharges
38 were \$4.58 million. The remaining \$1.8 million represents an undercharge of production
39 costs for the first quarter of 2000. Further, Mr. Larson treats the 1999 undercharge as if it
40 were being recovered over three quarters of the year, not the entire year.

41 Surrebuttal Exhibit 7.1 shows that Freeman is currently billing CILCO \$43 per ton
42 for Crown II coal. Subtracting the 1999 undercharge of \$4.58 million, which is equal to

43 \$4.58 per ton when allocated over the full million tons per year, the net charge for production
44 through the first three quarters is \$38.42 per ton, before taxes. Adding the taxes, the price is
45 \$40.82 per ton, not the \$31.90 suggested by Mr. Larson. These calculations directly support
46 the calculation of a cost of \$41.36 per ton contained in my rebuttal testimony. Based upon
47 these two calculations, the average price of Crown II coal is \$41.09 per ton.

48 Q7: You have stated that Mr. Larson's proposals are arbitrary. Please explain.

49 A7: When Mr. Larson suggested in his direct testimony that CILCO could reduce its coal costs
50 by reducing production at the Crown II mine by 500,000 tons annually, CILCO furnished
51 Mr. Larson with a copy of a study completed in 1995 showing that the reduction in output
52 would not reduce costs. In his rebuttal testimony, Mr. Larson arbitrarily rejected that study
53 on the ground that it is five years old. CILCO regularly audits the mine costs and visits the
54 mine, and has seen no change that would require a new study. Further, it is not reasonable
55 to assume that if production were cut in half, the average cost per ton for the remaining
56 production would not increase. Even if the number of miners were decreased by 50%, which
57 is highly unlikely, the fixed costs would not decline and would be double for the tons taken.

58 Q8: Are there other factors that should have been considered by Mr. Larson?

59 A8: Yes. The 1995 report indicates that the overall lowest cost of coal that would be incurred by
60 CILCO is if production from the Crown II mine were increased to 1,664,000 tons per year.
61 Under those circumstances, and based upon 1995 costs, the cost per ton to CILCO would be
62 \$32.96, as opposed to \$58.58 per ton if production were reduced to 500,000 tons per year.
63 Freeman is currently producing approximately 1.6 million tons per year from the Crown II
64 mine to achieve the lower per ton costs that result from increased production. Under the
65 circumstances, it would be unreasonable for CILCO to reduce the tonnage from the Crown

66 II mine by 500,000 tons per year.

67 Q9: Mr. Larson states in his rebuttal testimony that he included the entire profit factor of \$6.328
68 million per year when he calculated the savings that could be achieved by reducing the
69 Crown II tonnage by 500,000 tons. Do you agree?

70 A9: Based upon my review of Mr. Larson's calculations, I cannot agree. CILCO Surrebuttal
71 Exhibit 7.2 is a copy of the spread sheet Mr. Larson furnished to CILCO as the basis for his
72 calculations. As I analyze the spread sheet, for the six months July 2000 through December
73 2000, Mr. Larson calculated a profit requirement of only \$1,670,149. He reached this total
74 by multiplying the reduced tonnage of 263,930 tons taken during the six months by \$6.328,
75 the profit factor for each ton taken. However, because the required annual profit factor is
76 \$6.328 per ton for a minimum of 1,000,000 tons, when the tonnage is reduced by half, to
77 500,000, the profit factor must be doubled to \$12.565 per ton. Mr. Larson failed to do this,
78 and thereby understated the profit factor by half. The same error occurred in Mr. Larson's
79 calculation of the profit for the full year 2001. Mr. Larson multiplied the 503,514 tons to be
80 taken from the Crown II mine under his scenario by the per ton profit factor of ~~\$6.238~~ ^{\$6.328}.
81 Because only half the annual required tonnage was included in Mr. Larson's calculations,
82 the profit factor for 500,000 tons must be doubled, to \$12.565 per ton. Differently stated,
83 instead of including a total profit factor of ~~\$6,238,000~~ ^{\$6,328,000} for all of 2001, Mr. Larson has
84 included only half the correct amount, or \$3,186,234. Mr. Larson's spread sheet also shows
85 an incorrect price of only \$16.20 per ton for Turriss coal to be used at Duck Creek during
86 2001. This price is far below the quote of \$20.25 per ton, before tax, that CILCO received
87 from Turriss for Duck Creek usage during 2001. The correct figure, after adding tax of 6.25%,
88 is \$21.52 per ton. Based upon these errors, Mr. Larson has overstated the alleged savings in

\$6.59

\$3.14

2001 related to a tonnage reduction from the Crown II mine by ~~\$6.64~~ million, \$3.45 million in connection with the understatement of Turris costs and ~~\$3.19~~ million in connection with the understatement of the annual profit factor. Coupled with the fact that fixed costs will continue at the same level, and that labor costs will not decline on a pro rata basis if the tonnage is reduced, there is no saving that will result from Mr. Larson's proposal.

Q10: Mr. Larson states that CILCO has not adequately explained the 50% increase in costs at the end of March, 2000. What is your response?

A10: The actual increase was from \$31.45 per ton to \$43 per ton, or \$11.55 per ton, an increase of less than 37%. This increase is fully accounted for by an increase of \$4.58 per ton to reflect the 1999 underbilling of \$4.58 million ($\$4,580,000/1,000,000 = \4.58), plus the underbilling of \$1.8 million in the first quarter of 2000. The \$1.8 million underbilling of production costs for the first quarter indicates higher production costs of \$7.2 million per year, or \$7.20 per ton, for 2000. The two increases total \$11.78 per ton, fully accounting for the \$11.55 increase as of April of 2000.

Q11: IIEC witness Dauphinais states in his rebuttal testimony that CILCO's Form 1 filing at FERC for the year 1999 shows that CILCO purchased a total of 272,023 Mwh of economy energy from three other electric utilities and a municipal generator during 1999 at an average price of \$27.06 per Mwh. Mr. Dauphinais argues that this average price is below the price of \$51.59 per Mwh during 1999 as reported by *Power Markets Week*. From this, Mr. Dauphinais concludes that CILCO continues to purchase economy power on occasion, and that CILCO must include some economy power in the forecast test period proposed in this proceeding. What is CILCO's response?

A11: Mr. Dauphinais' assumption that the 1999 purchases he describes were actually economy

112 purchases is incorrect. Economy purchases are non-firm purchases made by a utility only
113 when the price of the power and energy to be purchased is less than the incremental cost of
114 generation from the utility's own generating units, or when the utility can reduce costs by
115 substituting economy power for other purchased power. The incremental cost of generation
116 at CILCO's Duck Creek and Edwards plants averages less than \$18 per Mwh. Consequently,
117 the purchases described by Mr. Dauphinais clearly were not for "economy" purposes when
118 compared with the cost of CILCO's own generation. Further, purchases of interruptible
119 power would not be made to replace firm purchases already in place on a take-or-pay basis,
120 because it would result in an increase in cost, not a reduction. Therefore, the 1999 purchases
121 described by Mr. Dauphinais could not have been for economy purposes.

122 Mr. Dauphinais testified on rebuttal in Docket No. 99-0468, involving CILCO's
123 1999 FAC reconciliation, that economy energy is purchased under service schedules that are
124 part of Interconnection Agreements between utilities. Mr. Dauphinais pointed out in his
125 testimony that under Service Schedule C of the CILCO/CIPS interconnection agreement,
126 economy energy is interruptible, and the service schedule "provides that a party is entitled
127 to receive such non-firm energy if it has alternative dependable capacity concurrently
128 available to it that could otherwise be used. Therefore, CILCO can use interruptible energy
129 to serve its native retail customers providing it has other capacity available to backup such
130 energy purchases." (Dauphinais Rebuttal Testimony, page 12.) Differently stated, CILCO
131 would have to have generation available which it could back down or put on reserve in order
132 to substitute less expensive energy. As I pointed out above, CILCO would not substitute
133 energy at \$27.06 per Mwh for CILCO's own generation, nor would CILCO substitute

134 interruptible energy for firm, take-or-pay energy under power purchase agreements secured
135 to meet requirements in excess of CILCO's generating capacity, because CILCO cannot back
136 down the scheduled purchases under those contracts. Further, the pricing of economy
137 purchases is determined by splitting the difference between the purchasing utility's cost to
138 generate and the selling utility's cost to generate. The 1999 purchases described by Mr.
139 Dauphinais in his rebuttal testimony in this proceeding were not made under service
140 schedules, but under market-based tariffs approved by FERC. As far as I am aware, no
141 purchases have been made by CILCO under the economy energy service schedules of
142 interchange agreements for at least two years. CILCO expects that other utilities will
143 continue to offer energy only under market-based tariffs in the future. Accordingly, there is
144 no foundation for Mr. Dauphinais' contention that CILCO should have included economy
145 purchases in its test period.

146 Q12: Mr. Dauphinais submits as Schedule 5 to his rebuttal testimony a copy of CILCO's response
147 to a data request in Docket No. 99-0468, in which IIEC asked if CILCO had purchased
148 economy energy any time in the past five years. CILCO's response was:

149 Yes. CILCO purchases economy energy, when available and usable. The availability
150 of energy, with costs less than hourly operating costs, is usually greater during the
151 low usage or off-peak time periods. Minimum load operating limits at times constrain
152 the ability to use economy energy during low usage or off-peak time periods.

153 Is this response by CILCO inconsistent with CILCO's position that economy energy is no
154 longer available?

155 A12: No, the data response and my testimony on this issue are completely consistent. CILCO had
156 purchased economy energy during the five years preceding the response to the data request,
157 and CILCO would still purchase economy energy if it were "available and usable." Mr.

158 Dauphinais recognized in his rebuttal testimony in Docket No. 99-0468 that the data
 159 response referred to occurrences in the past, because he testified that "CILCO has purchased
 160 economy energy in the past to serve its native load customers." (P. 11.) Mr. Dauphinais also
 161 recognized in that testimony that economy purchases are made by CILCO only "to reduce
 162 its cost to serve native load." (P. 12.) CILCO does not expect energy will be available at any
 163 time in the foreseeable future at prices below CILCO's own cost to generate, nor would
 164 CILCO be able to reduce overall costs by substituting non-firm energy for firm take-or-pay
 165 power purchases. Mr. Dauphinais acknowledged the latter proposition in his testimony in
 166 Docket No. 99-0468. (Tr. 358.)

167 Q13: Does this complete your prepared surrebuttal testimony?

168 A13: Yes, it does.